No. 10,943

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SAN MATEO FEED & FUEL COMPANY (a corporation), and H. E. CASEY COMPANY (a copartnership),

Appellants,

vs.

G. S. HAYWARD, as Trustee in the Matter of Joseph Louis Scardino, Bankrupt,

Appellee.

APPELLANTS' OPENING BRIEF.

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JURISDICTION.

This is an appeal by appellants, San Mateo Feed & Fuel Co., a corporation, and H. E. Casey Company, a copartnership, from an order (Tr. 250) of the Honorable A. F. St. Sure, one of the judges of the U. S. District Court for the Northern District of California, Southern Division, affirming upon review, an order of Honorable Burton J. Wyman, Referee in Bankruptcy, directing appellants H. E. Casey Company to turn over the sum of $2534.76 and San Mateo Feed & Fuel Co., a corporation, the sum of $1025.35 respec-

tively to G. S. Hayward, Trustee of the estate of Joseph Louis Scardino, Bankrupt. (Tr. 230.)

The District Court had jurisdiction under Section 2-a (15) of the Bankruptcy Act. The appeal is taken to this Court under Section 24 of the Bankruptcy Act.

STATEMENT OF THE CASE.

(a) The appeal.

The trustee, appellee herein, filed on April 2, 1943, with the Referee in Bankruptcy in the Court below her verified petition alleging that the respective amounts which appellants were ordered by the Referee to turn over to her were assets of the bankrupt estate and that the sums of money were assigned by the bankrupt to appellants within four months of the bankruptcy proceedings without consideration; that appellants knew the bankrupt was insolvent; that the moneys so received by respondents, appellants herein, were held by them without color or right. (Tr. 16.)

The Referee issued, pursuant to said trustee's petition, an order to show cause. (Tr. 19.) Respondents filed their answers. (Tr. 20-23.)

After a hearing, the Referee, on September 15, 1943, made and filed an order dismissing the trustee's petition without prejudice to said trustee within ten days thereof taking such further steps as she may be advised by virtue of the provisions of Section 70-e of the Bankruptcy Act. (Tr. 26.)

Thereafter the trustee filed a petition to review the Referee's order accompanied by an affidavit of the bankrupt and, pursuant to the petition for review, the Referee then sent up to the District Judge his certificate recommending that the judge return the records to him for further proceedings. (Tr. 3.)

On October 4, 1943, the District Judge ordered the records returned to the Referee. (Tr. 57.)

On November 8, 1943, a notice of a further hearing on the trustee's petition for a turn-over order directed to respondents, appellants herein, to be held on November 22, 1943 at 2 o'clock P.M., was filed. (Tr. 234.)

On December 27, 1943 the Referee made and filed his order directing appellants to turn over to the trustee the sums of $2534.76 by H. E. Casey Company and $1025.35 by San Mateo Feed & Fuel Co. upon the grounds stated in said order. (Tr. 239.)

On February 25, 1944 appellant H. E. Casey Company filed its petition for review. (Tr. 249.)

On February 26, 1944 appellant San Mateo Feed & Fuel Co. filed its petition for review. (See Referee's certificate.) (Tr. 226.)

On October 13, 1944 the District Judge made and entered an order confirming the proceedings and findings of the Referee. In said order the District Judge said:

> "It appearing that there was no actual fraud on the part of petitioners in accepting the preferential payments complained of by the trustee,

and it appearing that they have not filed creditors claims in said bankruptcy proceedings, they will be permitted, if so advised, to file such claims within thirty days from the date hereof." (Tr. 250.)

On November 10, 1944 appellants filed their notice of appeal (Tr. 251) and thereafter perfected same.

(b) The evidence.

The bankrupt was a plaster contractor and had certain building contracts with Conway & Culligan which required materials to be furnished (in addition to bankrupt's labor thereon). Appellants furnished the materials and Conway & Culligan, owners of the buildings which were being constructed and upon which the bankrupt was the plaster contractor, agreed to issue their checks payable jointly to the bankrupt and the material men furnishing the materials. (Tr. 155-7, 165, 184, 192.) Later their checks were issued directly to the material men including appellant, the reason being that the bankrupt had discontinued the work to be performed on his contract and, therefore, the contract had to be finished by someone else.

The bankrupt has had business transactions with appellant H. E. Casey Company ever since the year 1927 (Tr. 74) and also with appellant San Mateo Feed & Fuel Co. for many years prior to his bankruptcy.

During the hearing the bankrupt testified that he gave appellants the authority to collect the money due him from Conway & Culligan because he knew appel-

lants otherwise could lien the jobs and get it. (Tr. 77-8.)

ARGUMENT.

POINT 1.

(a) THE SAID ORDER HEREIN APPEALED FROM IS NOT SUPPORTED BY AND IS CONTRARY TO THE EVIDENCE ADDUCED BY APPELLANTS AND BY APPELLEE UPON THE HEARING AND UPON THE FURTHER HEARING OF SAID APPELLEE'S PETITION FOR TURNOVER ORDER (FILED APRIL 2, 1943).

In confirming the order of the Referee directing the appellants to turn over to the trustee the sums referred to in the Referee's order, the District Judge expressly recognized that appellants' transactions with the bankrupt were not fraudulent and consequently the appellants were not fraudulent transferees. However the order of the Referee and the findings therein contained, which are confirmed and adopted by the District Judge, to say the least are ambiguous for it cannot be ascertained therefrom whether the Referee intended to hold that appellants had obtained a fraudulent transfer of the bankrupt's assets without any consideration therefor and, therefore, was a trustee for the bankrupt at the time of the commencement of the bankruptcy proceedings, or whether appellants, and each of them, had obtained preferential transfers voidable under the provisions of the Bankruptcy Act.

In view of the District Judge's order and the language contained therein, we must assume that the Referee's proceedings were affirmed by the District

Judge upon the theory that voidable preferential transfers under the Bankruptcy Act had been proven against the appellants. The record, however, not only does not support any fraudulent transfers but likewise cannot support any voidable preferential transfers (as intimated in the Referee's ruling directing the turnover order to be entered against appellants) because the order of re-reference made by the District Judge on October 4, 1943 (Tr. 58), and the Referee's original order dismissing the trustee's petition (Tr. 27) in effect limited the "further hearing" to a proceeding under Sec. 70-e of the Bankruptcy Act.

POINT 2.

(b) THAT THE FINDINGS OF SAID REFEREE CONTAINED IN HIS SAID ORDER DATED DECEMBER 27, 1943, TO-WIT: FINDINGS NUMBERED (3), (4), (6), (8), (10), (11) AND (13) THEREOF, ARE NOT SUPPORTED BY AND ARE CONTRARY TO THE EVIDENCE ADDUCED BY APPELLANTS AND BY SAID APPELLEE UPON THE AFORESAID HEARING AND FURTHER HEARING OF SAID TRUSTEE'S PETITION FOR TURNOVER ORDER.

Being of the opinion, as we are, that the District Judge found that the record was void of any elements upon which a fraudulent transfer could be sustained, we must now approach a discussion of the District Judge's order upon the theory that he intended to affirm the Referee's proceedings, under the theory that the appellants had received voidable preferential transfers.

It is important, however, to observe that a preferential transfer requires certain elements to sustain

it. It is a statutory cause of action given under the Bankruptcy Act. The elements required to sustain a proceeding of a trustee in bankruptcy to set aside a voidable transfer alleged to have been obtained by a creditor are as follows:

1st Element. A transfer on an antecedent indebtedness;

2nd Element. A transfer made by an insolvent debtor.

3rd Element. A transfer made within four (4) months before bankruptcy;

4th Element. A transfer resulting in an advantage to a creditor, that is to say, a transfer that will enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

5th Element. Reasonable cause for the creditor to believe the debtor is insolvent.

Therefore whenever the term "voidable preference" is used in a proceeding to recover such voidable preference, it means the transaction has all five (5) elements or the characteristics above mentioned. If any of these elements are missing, either in pleading or proof, the transaction cannot result in the recovery by the trustee of a voidable preference under the Bankruptcy Act.

Proof of the first element must be entirely discarded for the reason that the record affirmatively shows that the checks made payable jointly to the bankrupt and to the material men were for a present considera-

tion, to-wit: the furnishing of material at the time the agreement was made for the completion of the construction of the premises being constructed by Conway & Culligan. (Tr. 152.) The failure to sustain the first element of proof required necessarily negatives the proof of the third element for the reason that if a transfer is made for a present consideration, even though it be within four (4) months period, it is not voidable. And proof of the fourth element is also wanting for the reason that if the transfer is made for a present consideration, there is no advantage to the creditor thus contracting with the bankrupt for payment, nor does it place such creditor in the category of the holder of an antecedent indebtedness. With respect to "Reasonable cause to believe" (the fifth element) although obviously essential, the record uncontradictorily discloses a denial upon the part of the Court below of the appellants' offer to produce such proof which would negative the existence of such fifth element even though the trustee originally was required to assume the burden of proof. (Tr. 109-112.)

> "The burden of proving such knowledge or such facts as would put a reasonable man upon inquiry rested upon the trustee. That burden was not here sustained."
>
> *Closson v. Newberry's Hdw. Co.,* 283 Fed. 33.

> "The burden of proof is on the complainant and unless he shows by sufficient evidence the element of a voidable preference, he is not entitled to recover. He must prove that the bankrupt (1) while insolvent, (2) within four months of the bankruptcy, (3) made his transfer of the prop-

erty, e.g., a payment of money, (4) and that the creditor receiving the payment was thereby enabled to obtain a greater percentage of his debt than other creditors of the same class; and it must also be proved, (5) that the person receiving the payment or to be benefited thereby, had reasonable cause to believe that it was thereby intended to give a preference."

Tumlin v. Bryan, 165 Fed. 166.

"We have searched the record diligently for evidence bearing upon this item of $33,526.94 with special reference to the record pages to which we have been directed by the briefs, and being always mindful that the trustee bore the burden of establishing a voidable preference, we have not been able to find anything substantial to support the trustee's position. We have discovered isolated bits of evidence tending very strongly to show that this money arose from the sale of cars impresed with a lien in favor of C.C.T. as contended by it but little to support the trustee except his theory. In this state of the record we think the trustee failed to carry the burden on this item."

Larkin v. Welch (C. C. A., 7th Cir.), 86 Fed. (2d) 442.

POINT 3.

(c) THAT SAID TRUSTEE'S PETITION FOR TURNOVER ORDER (FILED APRIL 2, 1943) DOES NOT STATE FACTS SUFFICIENT TO WARRANT THE GRANTING BY SAID DISTRICT COURT TO APPELLEE OF THE RELIEF THEREIN PRAYED FOR AND/OR THE RELIEF GRANTED TO APPELLEE BY SAID REFEREE'S ORDER DATED DECEMBER 27, 1943.

The Trustee's Petition for Turnover Order (Tr. 16) does not contain any allegations of the first, second, or fourth essential elements of a voidable preference. This clearly shows that the appellee's theory of this case, as so pleaded, was founded on the "fraudulent conveyance" (without payment of consideration) theory rather than on the "voidable preference" theory. Some of these defects in the trustee's pleading and proof, the Referee, in his Findings (for the first time) endeavored to remedy. (Findings Nos. (5), (6), (9), and (10).) (Tr. 236-7.) But even the Referee omitted therefrom a finding on the first essential element of a preference, i.e., that appellants' claims were founded on an "antecedent indebtedness".

Also great reliance is placed by the Trustee upon the so-called Trustee's Exhibit No. 1 (Tr. 41) as being proof by him of an assignment made within four (4) months. However the record taken in its entirety does not bear out such construction. Any letter of instruction or document given by the bankrupt or anyone else for him which places a creditor in possession of assets of the debtor which already belong to him by reason of the transaction occurring more than four (4) months before bankruptcy, does not create an assignment within the meaning of the Act. There is

no depletion of the estate; the creditor when he received such property of the debtor received only what he is already entitled to receive. (Tr. 150-152.)

POINT 4.

(d) THAT SAID REFEREE IMPROPERLY RECEIVED AND CONSIDERED AS EVIDENCE AGAINST APPELLANTS, UPON THE SAID HEARING AND FURTHER HEARING OF SAID PETITION FOR TURNOVER ORDER ALL OF THE RECORDS OF THE BANKRUPTCY PROCEEDING, INCLUDING THE BANKRUPT'S SCHEDULE AND THE EX PARTE AFFIDAVIT FILED BY THE BANKRUPT IN SUPPORT OF THE TRUSTEE'S PETITION FOR REVIEW OF SAID REFEREE'S ORIGINAL ORDER (DATED SEPTEMBER 15, 1943) MADE UPON SAID PETITION FOR TURNOVER ORDER, IN THAT BOTH SAID SCHEDULE AND SAID AFFIDAVIT WERE NOT BINDING UPON AND CONSTITUTED HEARSAY AS AGAINST APPELLANTS.

Contrary to the Referee's belief, as expressed by him during the hearing, the rule of evidence in a trial of a preferential transfer is no different than any other triable issue. Any evidence competent to enable the lower Court to properly determine whether the fifth element existed should have been received and considered; instead, however, the Referee arbitrarily declined to do so stating that it makes no difference as to what the course of business dealings had been prior to bankruptcy but that if the transaction occurred within four (4) months of bankruptcy, that appeared to be the end of it. (Tr. 76; 90-93.)

The learned authority of *Remington,* 4th Ed. states the rule upon a question of determining a preferential transfer and the admissibility of evidence to be as follows, "and the admissibility of the evidence is to

be determined by the usual rules." *Remington,* 4th Ed., Sec. 2301, page 450.

> "The burden of proof is usually on the plaintiff. This is peculiarly true where it is asserted that in bankruptcy a preference has been made. The legality of the evidence offered to sustain this burden must of course be determined by the usual rules."
>
> *Rosenman v. Coppard,* 228 Fed. 114.

In *Remington,* 4th Ed., Sec. 2260, the author states:

> "The schedules of the bankrupt are inadmissible against a transferee. They are not his admission. Likewise a general examination of the bankrupt is inadmissible." (See cases cited thereat.)

In a case almost similar to the instant case, the Court stated:

> "These schedules and part of the evidence so given by him in the bankruptcy proceedings were offered in evidence by the plaintiff upon the trial for the purpose of establishing the insolvency of the said Nichols at that time. To this offer the defendant objected, that as to him they were hearsay and that he was not bound by these declarations. The objections were overruled, the evidence was admitted, and the defendant excepted to the ruling. We are unable to see upon what ground this evidence was competent. It was the declaration of a bankrupt in a proceeding in which it does not appear that this defendant was a party. As to this defendant the evidence would seem clearly to be hearsay and inadmissible."
>
> *Taylor v. Nichols,* 134 App. Div. 787, 119 N. Y. Supp. 1042, 23 A. B. R. 310.

POINT 5.

(e) THAT ALL OF THE EVIDENCE ADDUCED UPON THE SAID HEARING AND FURTHER HEARING OF SAID PETITION FOR TURNOVER ORDER WAS INSUFFICIENT TO WARRANT THE DISTRICT COURT IN GRANTING TO APPELLEE THE RELIEF CONTAINED IN SAID REFEREE'S ORDER DATED DECEMBER 27, 1943.

Great reliance is placed by the Trustee upon the so-called Trustee's Exhibit No. 1 as being proof by him of an assignment made within four (4) months, which is referred to in our discussion under Point 3. If the lower Court had accepted the offer of proof as tendered by appellants, the evidence would have clearly supported appellants' contention under the point urged above.

"Mr. Mullin. Q. Well, it was quite common, was it not, for the credit managers, both of the San Mateo Feed & Fuel Company and H. E. Casey Company, to come and call on you for payments over a period of years?

A. Not as early as I started business. After about a year or so, they used to come often.

Q. From 1938 on?

A. Just about '38, and as a matter of fact, as I say before, I complained at that time that they should not do that. They went to the general contractor and tell them don't make the check on my name alone, make a joint check whenever payments are coming, either the first or second account.

Q. It was quite common for you in your business, from 1938 on at least, to have checks from the general contractor to you as subcontractor, to be made payable jointly to you and the material house who supplied you sand, plaster, or the materials used?

A. I did not sign anything. They got it without my authority. They tell the general contractor whenever they make a check to Scardino, don't make it to his name alone.

Q. You knew that at the time?

A. I knew it was done. I went to Mr. Casey and complained about it. I went to the bookkeeper and all. Mr. Casey knew that, too. I went in the office.

Q. You continued buying merchandise?

A. Yes.

Q. And it was also quite common with you to get assignments, authorized assignments, from the general contractor to make payments to your material men, was it not?

Mr. Margolis. Objected to on the ground that it is argumentative. It is not material whether or not he gave assignments heretofore.

Mr. Mullin. If the Court please, I propose to show an established custom and practice with this bankrupt in his business over a period of years.

The Referee. Why would that make a difference, if it was done within four months and violated the Bankruptcy Act?

Mr. Mullin. Your Honor, my understanding of the Bankruptcy Act may not be correct, but my understanding is, that any assignment that has been taken in good faith for adequate consideration is a good assignment, although made within four months.

The Referee. Well, you can show that each one you have here was for adequate consideration, but the fact that it went on over a number of years would not mean that one might be absolutely valid and the next one not.

Mr. Mullin. Unfortunately, Your Honor, in presenting proof you cannot offer it all at once. But I ask to establish a custom with this man.

The Referee. In face of the objection, that is not good.

Mr. Mullin. For the purpose of the record in the matter, I would like the record to show that H. E. Casey Company makes an offer to prove, to show that the practice of assignments had been common with the bankrupt and with others during all the period of years prior to the filing of this bankruptcy.

The Referee. That may go in the record."

(Tr. 74-75-76.)

The learned authority of *Remington,* 4th Ed., states the rule upon a question of determining a preferential transfer and the admissibility of evidence to be as follows, "and the admissibility of the evidence is to be determined by the usual rules." *Remington,* 4th Ed., Sec. 2301, page 450.

POINT 6.

(f) THAT THE EVIDENCE ADDUCED UPON SAID HEARING AND FURTHER HEARING UPON SAID PETITION FOR TURNOVER ORDER SHOWS AFFIRMATIVELY, AND CONTRARY TO THE FINDINGS OF SAID REFEREE CONTAINED IN SAID ORDER DATED DECEMBER 27, 1943, THAT THE ASSIGNMENT OF SAID RESPECTIVE SUMS OF $1025.35 AND $2534.76 TO APPELLANTS BY THE BANKRUPT WAS MADE MORE THAN FOUR MONTHS PRIOR TO THE COMMENCEMENT OF SAID BANKRUPTCY PROCEEDINGS AND WAS MADE FOR A PRESENT VALUABLE AND ADEQUATE CONSIDERATION; AND THAT EVEN IF MADE WITHIN SAID FOUR MONTHS' PERIOD, SAID ASSIGNMENT WAS THEN MADE TO APPELLANTS FOR A CURRENT VALUABLE AND ADEQUATE CONSIDERATION.

In view of the statements contained in the District Judge's order confirming the Referee's proceedings, we cite the following cases:

> "An attempt to prefer is not to be confounded with an attempt to defraud, nor a preferential transfer with a fraudulent one."
>
> *Githens v. Shiffler,* 112 Fed. 505.

> "In a preferential transfer the fraud is constructive or technical, consisting in the infraction of that rule of equal distribution among all creditors which it is the policy of the law to enforce when all cannot be fully paid. In a fraudulent transfer *the fraud is actual*—the bankrupt has secured an advantage for himself out of what in law should belong to his creditors, and not to him." (Emphasis supplied.)
>
> *In re Maher,* 144 Fed. 503, at p. 505.

We desire to stress that there is a distinct importance here to the variance between the pleading and the proof, and the trustee's omission to properly plead

a preference becomes more apparent when it appears that the Referee's Finding No. (4) indicates that the "assignments" to the appellants by the bankrupt were made "without any consideration therefor" (Tr. 236), despite his other findings, and the clear import of the evidence in the record. If the letter of February 20, 1942 (Tr. 48-49), is to be construed as an assignment (which of course is disputed by appellants) it was made obviously for a good consideration and is unassailable in a bankruptcy proceeding for two reasons:

First, it was merely an order to carry out the original obligation of Conway & Culligan to pay the materialmen for materials furnished on their job and which were agreed to be paid to them at the time the materials were furnished (Tr. 159-160);

Second, even if the unpaid bills were antecedent debts, the payment of an antecedent debt is a good consideration within the meaning of Section 70-e. We are, of course, not unmindful that in the trial of a voidable preferential transfer properly pleaded and proved by the trustee if all the elements of a preference exist, the payment of an antecedent indebtedness may constitute a recoverable preference.

The appellants obviously were prejudiced by the change in theory of the trustee's case both in the presentation thereof and in the erroneous determination thereof by the Referee because the specific issues upon which the re-reference and rehearing was ordered were clearly limited to the fraudulent conveyance theory and not preferential transfers which invites an entirely different order of proof. And the prejudice

becomes more apparent when it is considered that at this eleventh hour of the trial when the preferential transfer theory was invoked and appellants undertook to meet it, they were denied such privilege by the Referee's ruling. (Tr. 74-75-76.)

POINT 7.

(g) THAT IT AFFIRMATIVELY APPEARS FROM THE EVIDENCE ADDUCED UPON SAID HEARING AND FURTHER HEARING UPON SAID PETITION FOR TURNOVER ORDER, AND CONTRARY TO THE FINDINGS OF SAID REFEREE CONTAINED IN HIS SAID ORDER DATED DECEMBER 27, 1943, THAT IN AND BY THE AFORESAID ASSIGNMENTS OF THE AGGREGATE SUM OF $3560.11 TO APPELLANTS SAID BANKRUPT'S ESTATE WAS NOT DEPLETED TO THAT EXTENT, OR AT ALL, AND THAT SAID ASSIGNMENT DID NOT ENABLE APPELLANTS TO SECURE AN UNDUE ADVANTAGE OVER OTHER CREDITORS OF SAID BANKRUPT OF THE SAME CLASS; AND MORE PARTICULARLY, THAT APPELLANTS WERE AT ALL OF THE TIMES HEREIN MENTIONED SECURED RATHER THAN UNSECURED CREDITORS OF SAID BANKRUPT.

As it has been repeatedly stated by the Courts and urged herein by appellants, the burden is upon the trustee to prove each and every element in order to sustain a cause of action to recover a voidable preference. *Remington,* 4th Ed. Sec. 2289, and cases cited thereat.

The bankrupt testified:

"Cross-Examination.

Mr. Hoffmann. Q. Mr. Scardino, you say that between December and April the San Mateo Feed & Fuel Company and the Casey Company asked

you to make checks payable jointly to themselves? That is, that your debtor make checks payable to San Mateo Feed & Fuel Company and yourself?

A. I signed an assignment, according to the last time the check was made to them.

Q. All right. Your response to the question of your counsel here is, that between December, 1941 and the date you went into bankruptcy in 1942, the San Mateo Feed & Fuel Company, for one, asked that the checks drawn for work that you had done be made payable jointly to themselves and you. Is that correct?

A. I don't know, because they were made long before.

Q. Sure. They had been made like that for three or four years before, hadn't they?

A. No, no.

Q. You testified earlier they were made like that in 1940 and 1941?

A. What?

Q. Joint checks?

A. The checks was made, I don't remember when it started jointly, because they went to the general contractors and told them to make the check jointly.

Q. When did they do that?

A. I don't know. Ask them.

Q. They had been doing it for a period of three or four years, hadn't they?

A. No, it was lately.

Q. They had been doing it in 1941?

A. Yes.

Q. Hadn't they?

A. Not all; not all the general contractors, several; one on the Schmidt, one on the Young, one

on another one. They told them don't make checks for the first payment to me; make joint.

Q. That had been going on for a year or so before?

A. No, not a year before; probably four months, six months, five months, whatever it was.

Q. Is it not the fact that Conway & Culligan started doing business with you that way in 1937?

A. Conway & Culligan is separate, because all Conway & Culligan checks, he was operating on that line without anybody asking.

Q. And had been since 1937?

A. He was doing it all the time. Not just with me, but every one of the sub-contractors.

Q. You never objected to that way of doing business?

A. Yes, I did.

Q. To whom?

A. Well, I told to the manager and collector they should not do, because they spoil my business, I get no credit from those general contractors any more.

Q. Did you ever make an objection to Mr. Culligan of that firm?

A. I don't remember. Before I started business, they told me they would not make checks any other way. That settled it." (Tr. 150-152.)

The above quoted evidence is only a portion of the record which discloses conclusively that the materialmen, when they delivered the material to the jobs of the bankrupt, obtained a right against Conway & Culligan by virtue of their contract that all checks would be made payable jointly to the bankrupt and the materialmen. Consequently when the materialmen

took that portion of the check which belonged to them based upon a present consideration, to wit: The furnishing of material for the jobs, there was no depletion of the estate and thus it has been held that the trustee must show a depletion of a bankrupt estate in order to sustain the element of a voidable preferential transfer.

Remington, 4th Ed. Sec. 2289.50;
Dwight v. Horn, 26 A.B.R. (N.S.) 269.

POINT 8.

(h) THAT IT DOES NOT APPEAR FROM THE EVIDENCE ADDUCED UPON THE SAID HEARING AND FURTHER HEARING OF SAID PETITION FOR TURNOVER ORDER, NOR IS IT A FACT THAT AT THE TIME OF THE MAKING OF SAID ASSIGNMENT OF SAID AGGREGATE SUM OF $3560.11 TO APPELLANTS BY SAID BANKRUPT, SAID BANKRUPT WAS THEN AND THERE INSOLVENT NOR THAT APPELLANTS, OR EITHER OF THEM, THEN HAD REASONABLE CAUSE TO BELIEVE THAT SAID BANKRUPT WAS INSOLVENT.

If the rule were to make the schedule admissible as contended for by the Trustee and the Referee, the truth and the accuracy of the bankrupt's schedules retroactive to the time of the transfer would be the only evidentiary matter upon which the finding of insolvency in this case is attempted to be predicated. The fact that schedules were filed by the bankrupt, if that were material, would be the proper subject of judicial notice by the Referee but not the content of the schedules; therefore this was clearly an error on the part of the Referee.

"That the schedules filed by the bankrupt are inadmissible against the alleged preferred creditor

to prove the bankrupt's insolvency, being merely the admissions of an assignor after he has parted with his interest to the alleged preferred creditor;"

Remington on Bankruptcy, 4th Ed., Vol. 5, Sec. 2291, P. 445.

See also

Clifton Merc. Co. v. Conway, 264 S.W. 192, 4 A.B.R. (N.S.) 1164,

and cases cited therein.

We cannot emphasize too strongly that a voidable preferential transfer is one based upon the specific provisions of the Bankruptcy Act giving a cause of action to a trustee in bankruptcy to recover same and, therefore, all the elements necessary to sustain such a statutory cause of action must exist and be proven by competent evidence. (Merely that the bankrupt was in failing circumstances and unable to meet his debts is insufficient, such allegation or proof not being the equivalent of proof of insolvency, but the trustee must prove the insolvency as of the date of the transfer.)

The only evidence in the record of the insolvency of the bankrupt is an ex parte affidavit of the bankrupt which is clearly not admissible and the schedule of the bankrupt which also is clearly not admissible since the schedule and the ex parte statement of the bankrupt are not binding upon a preferential transferee of the bankrupt, it being gross "hearsay" evidence.

The Referee, however, in his certificate to the District Judge, although calling attention to the error al-

leged by appellants in the receipt and consideration by him of the bankrupt's schedule and ex parte affidavit, asserts that the affidavit was used solely for one purpose, as part of the trustee's offer of proof mentioned in said trustee's petition for review.

The Referee makes no effort to support the admission of the schedule in the evidence but advises the District Judge in his certificate that the affidavit of the bankrupt was used only in cross-examination. This, however, is contrary to the record for the reason that the Referee clearly announced the rule which he invoked upon the hearing before him regarding the introduction of the schedule and the affidavit.

As to the admission of the affidavit as part of the proceedings on the rehearing, the record discloses the following:

> "Mr. Margolis. We will offer the affidavit in evidence, your Honor, and let it go at that." (Tr. 171.)
>
> "Mr. Margolis. I think counsel has in mind that it is set out by affiant in the affidavit that the only property he had was $50.00 at the time he filed, which was subject to attachment."
>
> "The Referee. That is not disputed. *But anything so far as the affidavit stands.*" (Emphasis ours.) (Tr. 179.)

While no express ruling on the admissibility of the affidavit appears to have been made by the Referee, it is obvious, from his statement, that no express ruling was necessary to indicate to the litigant that the affidavit as filed by the bankrupt was being considered by him. In fact, he so stated.

As to the schedule, in the preamble to the Referee's findings numbered in chronological order appears his specific reference to and a resume of the names of creditors and amounts appearing in schedule a-3 (Tr. 235) filed by the bankrupt. The vice in the consideration of such ex parte statement in the bankrupt's schedule in order to establish the existence of certain creditors is that in truth and in fact the exact date as to when these indebtednesses were incurred cannot be ascertained from such schedule, and, therefore, the only admissible evidence regarding the existence of such claims would be the direct testimony of the bankrupt or the creditors coupled with the right of cross-examination.

That the Referee considered the petition and schedules as part of the evidence to sustain his findings of insolvency is indicated by the following:

> "Mr. Margolis. We, therefore, ask at this time, if it please your Honor, that the petition and schedules be introduced in evidence and marked as a portion of the record, by designating it Trustee's Exhibit 'A'.
>
> The Referee. They are part of the record anyway.
>
> Mr. Margolis. Yes, but I would like to offer them in evidence, your Honor.
>
> The Referee. You don't have to do it. Under the Federal Rule, they are before the Court and the Court will take into consideration everything in the record." (Tr. 144.)

While the General Rule permits the Court to take judicial knowledge of the contents of the record be-

fore it, this doctrine is limited to the fact of actions by that Court in the instant or other proceedings before it, and obviously the mere filing of an affidavit or a schedule by the bankrupt some weeks after he is claimed to have made a preferential transfer could not help but be self-serving, and therefore not binding upon the transferee in an action brought to recover such preference.

POINT 9.

(i) THAT IT DOES NOT APPEAR FROM THE EVIDENCE ADDUCED UPON THE SAID HEARING AND FURTHER HEARING OF SAID PETITION FOR TURNOVER ORDER, THAT THE ASSETS IN THE HANDS OF THE APPELLEE WERE INSUFFICIENT TO PAY IN FULL ALL OF THE CLAIMS OF CREDITORS FILED, APPROVED, AND ALLOWED AGAINST SAID BANKRUPT'S ESTATE.

Again alluding to the fact that the trustee must prove each and every element required to prove a voidable preference, it follows that he is required to prove that the assets in his hand were insufficient to pay in full the claims of creditors filed, approved and allowed against said bankrupt's estate. The record is devoid of any such proof. The schedules themselves do not prove claims which are filed, approved and allowed against a bankrupt's estate but obviously the Referee, in arriving at his conclusion, merely took from the bankrupt's schedule the "hearsay" statement of the bankrupt as to claims against the estate and considered that as evidence against appellants in order to prove the *allowed claims* against the estate. (Tr. 245-6.) (Emphasis ours.)

CONCLUSION.

Upon the record as made in these proceedings we earnestly urge that the lower Court has erred in finding or determining that the appellants, or either of them, have received voidable preferential transfers recoverable under the provisions of the Bankruptcy Act and that the order of the District Judge confirming the Referee's order of December 27, 1943 should be reversed and the matter remanded to the District Court with directions to enter an order denying the trustee's petition for turnover order.

Dated, San Francisco, California,
April 4, 1945.

Respectfully submitted,
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